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June 3, 2005

David M. Eichenlaub
Division of Economics and Finance
State Corporation Commission
1300 East Main Street
Richmond, VA 23219

Re: *Status of Competition -- Compliance by the State Corporation Commission with § 56-596.B of the Code of Virginia*

Dear Mr. Eichenlaub:

On behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (collectively, "the Committees"), which consist of large industrial customers of Dominion Virginia Power ("DVP") and Appalachian Power Company ("APCo"), respectively, we wish to respond to comments regarding market-based rates for default service.

In particular, Competitive Stakeholders suggest that the degree of success of retail electricity markets is largely dependent, among other things, upon the degree to which retail markets have addressed "default rates [that] reasonably reflect market prices, so that boom/bust cycles in retail markets are avoided."¹ Competitive Stakeholders recommend that the Commission "draw on experiences in other states in developing competitive options for all customers, including those receiving default service," and Competitive Stakeholders mention in particular customers now paying market rates in Maryland, the District of Columbia, and Pennsylvania.

In addition, WPS Energy Services, Inc. ("WPS") states that an auction for "standard offer service or provider of last resort service encourages a true market" and that "[a]uctioning off standard offer service provides a market-based rate for suppliers to compete against." According to WPS, a "true market based rate for suppliers to compete against *provides real savings to customers.*" (Emphasis added.)

In assessing these suggestions regarding market-based rates for default service, the Commission should take into account the experience of a number of communities in the western

¹ Competitive Stakeholders' comments were submitted on behalf of Constellation New Energy, Inc.; Direct Energy Services, LLC; and Strategic Energy, LLC.

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part of Virginia in which electricity customers are paying, or will be paying shortly, market-based rates. Retail customers served by municipally owned utilities that are members of the Blue Ridge Power Agency ("BRPA") face significant rate increases.² Such utilities have been served at wholesale under seven-year supply contracts with Cinergy; however, with expiration of the Cinergy contracts in 2005, almost all signed new, one-year contracts, based on current market prices, with American Electric Power ("AEP"). The AEP contracts are the result of BRPA's seeking wholesale bids through an RFP process. AEP was the low bidder. Nonetheless, the resulting rate increases for customers served by such utilities are enormous. For example, the largest of the communities, the City of Danville, reports a 78% increase in power supply costs, resulting in the following average percentage increases in rates to its retail customers:

Class	Average Percent Increase
Residential	35.3
Churches	20.4
Small general	25.9
Medium general	40.3
Large general	40.2
Lighting	28.0
Average	36.2

Other communities reportedly face similar increases.³ The City of Danville, moreover, expects its base rates to rise still further in 2006, by an average of 4.4%, in order to accommodate cost deferrals and other effects of the increase in purchased power costs resulting from the new contract.⁴ In addition, based on proposals recently requested by the City from utilities, prices are ranging 15% to 30% higher than those in the new AEP contract, according to the City, so electric rates may jump again to accommodate higher purchased power costs when the AEP contract expires.⁵

Section 56-585.C.1 of the Restructuring Act provides that, until the expiration or termination of capped rates, rates for default service will be the capped rates. After the expiration of capped rates, the rates for default services shall be the based upon competitive market prices for electric generation services. The capped rates currently are scheduled to expire on December 31, 2010, so customers must pay market-based rates for default service after that

² Municipally owned utilities that are members of the Blue Ridge Power Agency include Danville, Bedford, Bristol, Martinsville, Radford, Salem, and Richland.

³ Local newspapers report the following increases, for example: Radford (26-30%); Bristol (40-42%); Salem (approximately 40%); Bedford (41%).

⁴ Next year's expected base rate increases are as follows: residential, 3.6%; churches, 3.3%; small general, 2.7%; medium general, 4.2%; large general, 8.1%; lighting, 2.1%. These expected base rate increases do not include the effect of predicted increases in purchased power costs after July 1, 2006.

⁵ "More Utility Rate Hikes Expected Next Year," Danville Register & Bee, May 24, 2005.

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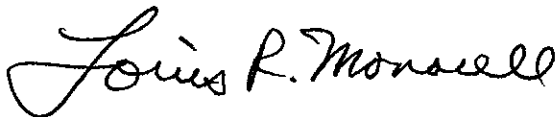
date. The gap between current market prices and Virginia utilities' capped rates does not bode well for customers, many of whom, depending upon the utility that serves them, could face adverse consequences similar to those being experienced by customers of BRPA members. APCo's "price to beat" for generation and transmission service for jurisdictional industrial customers, according to the Commission's calculation released on December 21, 2004, is 2.9 cents/kWh; current generation market prices, however, are running around 5 cents/kWh, more than 60% higher.

Admittedly, the rate shock experience of retail customers served by BRPA members result from a tremendous increase in wholesale prices as shown by the competitive bidding results in 1997 compared to now. Nonetheless, their experience illustrates that, although wholesale procurement may be done through a competitive bidding process, customers may be forced to pay significantly higher prices. In other words, just as competitive wholesale procurement has resulted in significant rate shock for retail customers of BRPA members, such procurement also could result in rate shock for retail customers of investor-owned utilities when their capped rates end.

In formulating the Commission's findings regarding the status of competition, and in developing recommendations to the General Assembly, the Committees urge the Commission to consider these developments. Electric restructuring has not worked so far in Virginia, and such developments do not bode well for its future success.

The Committees appreciate the opportunity to comment, and they look forward to continuing to assist the Commission in its response to the mandate contained in Virginia Code § 56-596.B.

Sincerely,



Louis R. Monacell



Edward L. Petrini